What's the lender liability risk for soil pollution in the People's Republic of China? An evaluation of China's new Soil Pollution and Control Law in the light of the USA and UK regimes

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Lessons from the West: An Evaluation of China's Soil Pollution and Control Law and the Risks for Lenders in light of the USA and UK Regimes

Abstract

This article analyses the prospective risks that may arise for lenders because of the enactment of China's Soil Pollution and Control law. Given that the Chinese legislation was enacted as recently as January 2019, the possible risks for lenders may not as yet be self-evident. However, this article provides a comparative analysis of the established land pollution regimes in the US and UK to demonstrate some of the risks that may arise when a new legislative non-compliance risk for land pollution is brought into force. The US and UK regimes have been chosen because they represent to sides of the same coin, in terms of their approaches to land remediation. The US has taken a far more litigious stance, and cases of lender liability have been found by the courts. The UK has not generated much direct liability – and no bank has been found culpable for remediation costs – but it has nevertheless created other risks for banks and has driven them to consider environmental risks. The article ends by outlining the categories of risks that may emerge for lenders because of the Chinese law, viz: (i) market risks; (ii) industry risks; and (iii) firm risks.

Introduction

In the last few years of the Anthropocene various attempts have been made by state actors to resolve environmental issues through the establishment of specific regulatory frameworks.[1] Such frameworks have been enforced to, *inter alia*, ensure the compliance of responsible parties together with reducing any environment-related risks that may exist. But this period of increased codification has also had a bearing upon lenders (e.g. secured creditors), specifically.[2] Over the last thirty years, lenders have responded to legislative non-compliance risks through the incorporation of specific environmental due diligence into their traditional risk management structures.[3] A most recent example of a piece of regulation that should be seen as a risk for lenders can be seen in the enactment and introduction of the Law of the People's Republic of China on Soil Pollution and Control 2019 (SPC).[4] This law forms the focus of this article's analysis, and a comparison is made between the SPC and the more well-established hazardous/polluted land regimes from the US and UK (see below).

[1] Take, for example, the codification of common law nuisance into Pt III of the Environmental Protection Act 1990.
[2] L.A. Brown, 'Land pollution, environmental risks and bank lending: An empirical analysis' (2015) 17(4) ELR 237
[3] Ibid. at 244-246
[4] Law of the People's Republic of China on Soil Pollution Control 2019 (SPC 2019)

Broadly speaking this article is concerned with the global regulation of "contaminated land" and its impact on lending institutions. However its specific focus is on establishing how the new Chinese law may affect lenders that are either based in China or have customers and lending interests in China. The width of the problem of contaminated land is well put by Tromans and Turrall-Clarke, who suggest that:

> 'Contamination of land may arise from a wide variety of activities. One category is the intentional deposit of material on land, whether as a means of disposing of that material, or in connection with development or construction activities. Examples of this are landfill sites, tips, lagoons for industrial effluent, deposits of dredgings, "made ground" and filled dock basins, and the deposit of sewage sludge or other materials on agricultural land. Another category is contamination arising incidentally in the course of industrial activity…'[5]

Thus, in light of the new Chinese law and given plethora of ways in which the contamination of land can occur, lenders must be alert to the risks that can arise by virtue of their borrowers' commercial lending activities. And this challenge for the lending community is made even more problematic when viewed from a global perspective.[6] Lenders have to be alert to laws that may impact their lending in different countries around the world, as loan finance is not conducted *in situ*. This is why an analysis of the potential risks that may spring from China's new law is important for this research area.

In terms of risks Hood suggests that a significant concern for lenders when a country enacts a new regulation governing land pollution issues is whether the lending community will be made directly liable for remediation costs[7] (also known as "lender liability"):[8]

> 'The critical issue for a lender, in environmental matters, is the extent to which it will be liable for the costs of cleaning-up the land which is found to be contaminated.'[9]

Jarvis and Fordham have questioned why it is important for lenders to involve themselves in international legal developments.[10] They suggest that, 'In the first place there is the obvious relevance to those whose commercial activities have an international flavour.'[11] Although Jarvis and Fordham were speaking in relation to a "trans-Atlantic" glance of lending risks,[12] their reasoning has nevertheless greatly influence the writing of this article. Therefore, to assess the risks that may spring from this new piece of legislation and attach themselves to banks, the article compares China's SPC law to the land

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[5] S. Tromans and R. Turrall-Clarke, *Contaminated Land*, 2nd edn (Sweet & Maxwell: London, 2007) 3
[6] P. Case, *Environmental risk management and corporate lending – a global perspective* (Cambridge: Woodhead Publishing)
[7] P. Hood, *Principles of Lender Liability* (OUP, 2012) para 13.01
[8] See Brown, above n. 2 at 244
[9] See Hood, above n. 7 at para 13.01
[10] J. Jarvis and M. Fordham, *Lender Liability: Environmental Risk and Debt* (Cameron May, 1992) 10
[11] Ibid
[12] Ibid

remediation regimes of the US and UK. The regulatory frameworks that are analysed are, respectively: (1) the Comprehensive Environmental Response, Compensation, and Liability Act 1980 (CERCLA 1980);[13] and (2) Pt IIA of the Environmental Protection Act 1990 (EPA 1990).[14] While examples could have been easily drawn from several other regimes (e.g. those of Germany, the Netherlands or Canada),[15] the US and UK were chosen for two, main reasons. First, CERLCA represents the pioneering example of a regulatory framework that was specifically designed to identify and remediate suspect tracts of polluted land.[16] And because this regime has been around for some three decades, it serves the article well as a linchpin to apply to the analysis of the newly adopted Chinese legislation. Second, the regulation in the US and UK should be seen as two sides of the same coin and an analysis of the two provides a well-rounded picture for discovering the possible risks that may emanate from China's SPC law. Case law dealing with CERCLA has shown how the US has taken a litigious approach to land remediation (see below). On the other side of that same coin however, the UK's approach has been far less direct in its enforcement of its contaminated land remediation.[17] In fact not one case of lender liability has ever been brought under Pt IIA.[18] But that is not to say that Pt IIA has been unsuccessful.[19] Indeed the indirect effect of the UK regime has led to significant changes in the UK's lending culture, without the need for lender liability and the possible decrease in the lenders' appetite for brownfield investment or the grant of loans to commercial customers operating in polluting industries.[20]

The following section looks specifically at China's SPC law. Before assessing the risks that may present themselves to lenders under the new law, the article sets out the comparable regimes from the US and UK. The below sections are therefore important for developing a contextual understanding of two frameworks that have been in operation for some time, since December 1980 (CERCLA) and April 2000 (Pt 2A). The final section submits guidance on the risks that may emerge from the new law, together with advice on how to mitigate such risks.

A lender's perspective of China's Soil Pollution and Control Law

The SPC law concerns 'the prevention and control of soil pollution'[21] of "agricultural land"[22] and "construction land".[23] The law was promulgated on 1 January 2019 following

[13] Comprehensive Environmental Response, Compensation, and Liability Act 1980 42 USC, ss 9601-9657 (hereafter, 42 USC)
[14] Hereafter, "Pt IIA" or "the contaminated land regime".
[15] See Tromans and Turralll-Clarke, above n. 5 at 680-710
[16] See Jarvis and Fordham, above n. 10 at 10
[17] See Brown, above n. 2 at 245
[18] Ibid.
[19] Ibid. at 246
[20] Ibid.
[21] SPC 2019, art. 3. SPC 2019, art. 2 provides a definition of "soil pollution" as: 'The term "soil pollution" as used in this Law refers to the phenomenon that a certain substance enters the surface soil of the land due to human factors, causing changes in soil chemical, physical and biological properties, affecting soil function and effective utilization, endangering public health or destroying the ecological environment.'
[22] Ibid. at arts. 49-57
[23] Ibid. at arts. 58-69

a presidential order confirming its adoption by the Fifth Session of the Standing Committee of the 13th National People's Congress of the People's Republic of China.[24] The date of its introduction is also codified by Article 99 of the law.[25] In an explanation of the reasons for the law on 22 June 2017 it was held that:

> 'Soil is one of the basic elements that constitute an ecosystem, the material basis on which human beings depend, and an indispensable resource for human society. Prevention and control of soil pollution is directly related to the quality and safety of agricultural products, the health of the people and the sustainable development of the economy and society. The problem of soil pollution is also concerned by the whole society with the problems of air and water pollution.'[26]

Before the enactment of the SPC law China lacked a specific regulatory framework for the prevention and control of soil pollution.[27] Therefore, given the lack of a coherent system before the introduction of this SPC, it is now necessary to highlight this new legislative compliance risk for the international lending community. For instance, Article 4 of the SPC law states that 'any organization or individual has the obligation to protect the soil and prevent soil pollution.'[28] It is further stated that the law applies to:

> 'Land use right holders are engaged in land development and utilization activities. Enterprises, institutions and other production and business operators engaged in production and business activities shall take effective measures to prevent and reduce soil pollution and take responsibility for the soil pollution caused.'[29]

The range of organisations or individuals that are within the law's remit of liability should be a concern for banks, especially given that "land use right holders" are also accountable. This could affect many of the lenders' clients and themselves directly. As shall be shown by the established regimes, the way in which such a provision is interpreted by the courts is considerable. A borrower that is determined as a "responsible person" may be so greatly affected that it is unable to repay its outstanding loan and may fall insolvent.[30] One must also question the extent of lender liability for remediation measures under this provision. For example, does "land use right holder" extend to secured creditors under loan agreements? Lenders will have to provide answers to this question to lend safely to borrowers.

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[24] The National People's Congress of the People's Republic of China, 'Presidential order of the people' (Chinese National People's Congress, 31 August 2018) http://www.npc.gov.cn/npc/xinwen/2018-08/31/content_2060272.htm accessed Monday 18 February 2019

[25] SPC 2019, art 99

[26] The National People's Congress of the People's Republic of China, 'Explanation of the Law of the People's Republic of China on Prevention and Control of Soil Pollution' (Chinese National People's Congress, 22 June 2017) http://www.npc.gov.cn/npc/xinwen/2018-08/31/content_2060169.htm accessed Monday 18 February 2019

[27] Ibid.

[28] SPC 2019, art. 4

[29] Ibid

[30] L.A. Brown, 'Bad debt and green issues: Managing environmental risks in borrowers' corporate insolvencies' 20(3) ELR 137

By virtue of Article 5 the "local people's governments" are responsible for administering the law at various levels in their areas,[31] and must incorporate the prevention and control of soil pollution into their national economic and social development plans.[32] This is an example of state delegation and, as such, the local people's governments can initiate strategies that are more stringent than that of the national standard.[33] For lenders specifically this is problematic because it means that they may have to understand the individual approaches that are used in the administrative areas where their borrowers' are based.

The part of the SPC law that applies to "prevention and protection"[34] shows a heightened responsibility for different projects and industries under the new regime. This may be problematic for lenders because they may have the added burden of undertaking increased due diligence before lending to certain borrowers. An example can be seen at Article 18 which states that environmental impact assessment (EIA) is now needed for all types of construction projects.[35]

The SPC law's approach to "risk management and repair" is one based on risk assessment[36] and survey reports on the soil pollution status.[37] The relevant departments of the local governments have the right:

> 'to require responsible persons of the soil pollution and land use rights holders to take such measures such as removing pollution sources and preventing the spread of pollution according to actual conditions.'[38]

The "responsible person" is the person to bear all expenses incurred,[39] even in the situation where a local government takes emergency measures to prevent soil pollution.[40] In respect to lending this part of the law is problematic because of the very great expense that is often required for undertaking remediation works on land, e.g., a borrower with such liability is more likely to fall insolvent.[41]

Lenders are mentioned by Article 72 of the Chinese law. The provision reads as follows:

> 'The State encourages financial institutions to increase credit supply for soil pollution risk control and rehabilitation projects.

[31] SPC 2019, arts. 5-6
[32] Ibid. at art. 11
[33] Ibid.
[34] Ibid. at ch. III
[35] Ibid. at art. 18
[36] Ibid. at art. 35 and 37
[37] Ibid. at art. 36
[38] Ibid. at art. 30
[39] Ibid. at art. 46
[40] Ibid. at art. 44
[41] See Brown, above n. 30 at 137-139

> The State encourages financial institutions to conduct soil pollution surveys when handling land rights mortgage business.'[42]

The above is interesting since it places a positive obligation on financial institutions to take part in the SPC regime. The first part presents a concern as supplying credit funding for risk control and rehabilitation projects is likely to be viewed as a high risk financial investment for lenders. Moreover the second part suggests that the lending community must now have an active role in surveying for soil pollution. This may require the engagement of external environmental professionals and cost implications on individual transactions.

The local governments will 'impose disciplinary sanctions on directly responsible persons and other directly responsible personnel.'[43] Liability is therefore allocated to any responsible person that commits certain acts by the local ecological department.[44] Unlike some regimes there is no exemption clause for lenders in the SPC law, which makes the financial institutions' position somewhat uncertain. The law states that where the responsible person cannot be found the land-use right holder is liable; and if the land is ownerless the government will pay for the costs.[45]

This section has set out the SPC law briefly and uses the lender's lens for analysis. Below a comparative analysis is adopted with the view to showing the potential risks that may emerge from China's regime. A discussion of lender liability for land remediation in the US is provided below. The article then looks at the UK approach.

The US approach: Comprehensive Environmental Response, Compensation, and Liability Act 1980

Following a serious of environmental disasters in the 1980s (e.g. the Love Canal Site at Niagara Falls, New York)[46] the US Government endeavoured to create a regulatory regime for dealing with abandoned, hazardous waste sites.[47] The result was CERCLA 1980, as amended.[48] This section looks specifically at how CERCLA generated instances of lender liability in the 1980s and 1990s, in a series of cases which analysed the degree of "participation" that is required for liability to attach to a responsible party. It is

[42] SPC 2019, art. 72
[43] Ibid. at art. 85
[44] Ibid. at art. 86
[45] T. Li, Y Liu, Y. Liu and Y. Xie, 'Soil Pollution Management in China: A Brief Introduction' (2019) 11 Sustainability 1, 10
[46] See Tromans and Turrall-Clarke, above n. 5 at 695. For an overview of the "Love Canal Disaster" see: E.C. Beck, 'The Love Canal Tragedy' (USEPA, no date) https://www.epa.gov/aboutepa/love-canal-tragedy accessed Saturday 9 February 2019
[47] Ibid. at 695; United States Environmental Protection Agency, 'Superfund: CERCLA Overview' (USEPA, no date) https://www.epa.gov/superfund/superfund-cercla-overview accessed Friday 15 February 2019
[48] See Tromans and Turrall-Clarke, above n. 5 at 696 which says: 'CERCLA has been amended several times since 1980, including the Superfund Amendments and Reauthorization Act (SARA), the 1996 Asset Conservation, Lender Liability, and Deposit Insurance Protection Act, and the 2002 Small Business Liability Relief and Brownfields Revitalization Act (Brownfields Amendments).'

noteworthy that the CERLA regime is somewhat similar to the SPC law because both use large funds to enforce control and protection measures.[49]

The "Superfund" regime

CERCLA is colloquially known as the "Superfund", *ipso facto* because the regulation initially relied on a large trust fund to carry out remediation works.[50] The trust fund was replenished annually by way of an industrial levy on chemical and petroleum industries.[51] This raised a total revenue of $1.6 billion within a five-year period[52] and much more thereafter.[53] The fund was to be used by the federal authority – the US Environmental Protection Agency (USEPA)[54] – where a site was left abandoned.[55] Tromans and Turrall-Clarke, referencing the case of *EPA v Sequa Corp (In the Matter of Bell Petroleum Servs., Inc),*[56] suggested that the purpose of setting the levy was deemed necessary to shift 'the cost of cleaning up environmental harm from the taxpayers to the parties who benefited from the disposal of wastes that caused the harm.'[57] But this may also have been because of the considerable remediation expenses of CERCLA sites, which at that time was based at an average of USD 25 million.[58] On 30 September 1994 Congress chose not to re-authorise the tax provision that allowed revenues to be collected and funding has since been supplemented by the US Congress' annual appropriations.[59]

> With respect to the CERLCA regime Jarvis and Fordham believe that:
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> 'The US provides the furthest developed illustration of primary lender liability. American lenders have found themselves responsible for clean-up costs arising from the polluting activities of their borrowers.'[60]

CERCLA liability is both strict and retrospective,[61] and there are four "potentially responsible parties" that can be held liable.[62] The CERCLA regime is administered by USEPA;[63] the federal authority responsible for identifying and allocating liability to responsible parties.[64] Together with the causer of the harm, an "owner or occupier[65] of a

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[49] See Li, Liu, Liu and Xie, above n. 45 at 9
[50] Tromans and Turrall-Clarke, above n. 5 at 695
[51] Ibid.
[52] US Environmental Protection Agency, 'Superfund: CERCLA Overview' (USEPA, no date) <https://www.epa.gov/superfund/superfund-cercla-overview> accessed Friday 15 February 2019
[53] See Jarvis and Fordham, above n. 10 at 10
[54] Ibid. at 11
[55] See Tromans and Turrall-Clarke, above n. 5 at 695
[56] *EPA v Sequa Corp (In the Matter of Bell Petroleum Servs., Inc)*, 3 F.3d 889, 897
[57] See Tromans and Turrall-Clarke, n. 5 at 695-696
[58] See Jarvis and Fordham, above n. 10 at 11
[59] L.A. Brown, 'Banks and Secured Lending: Environmental Risks and Due Diligence' (PhD thesis, Cardiff University, December 2014) 63
[60] See Jarvis and Fordham, above n. 5 at 10
[61] See Jarvis and Fordham, above n. 5 at 11
[62] 42 USC, s. 9607(a)
[63] Ibid. at s. 9601(2)
[64] Ibid. at ss. 9604 and 9606
[65] Ibid. at s. 9601(20)(i)-(iii)

vessel or facility" can be held liable for remediation costs.[66] This resembles the "land-use rights holder" in the SPC law. The presence of an owner or occupier liability provision in a piece of regulation is largely problematic for lenders.[67] It ultimately interferes with the ability to exercise security as foreclosure constitutes absolute ownership.[68]

Alternatively, and like the Government's powers in the SPC law, the recovery of costs could be requested by the USEPA following it undertaking remediation works.[69] This allows it to reduce any harm that may be caused by the hazardous land.[70] The costs for remediation are determined on a case-by-case basis[71] and are unlimited.[72]

The secured creditor exemption[73]

As noted above, the SPC law does not have an explicit statutory provision exonerating lenders by virtue of their providing or withholding financial assistance to a polluting party. Pt IIA attempts to exonerate "mortgagees not in possession" of property in its definition of the term "owner".[74] However, the inclusion of such a clause within the US legislation has proved problematic. To limit liability under CERCLA the secured creditor exemption was drafted into the law by Congress.[75] The exemption provided an exclusion for an "owner or operator" where it was the case that:[76]

> 'without participating in the management of a vessel or a facility, a person holds indicia of ownership primarily to protect his security interest in the vessel or facility.'[77]

This secured creditor exemption suggests that a bank in the ordinary course of its day-to-day financial activities would not be held liable. Its inclusion in CERCLA therefore shows how Congress was alert to the need to protect lenders and retain their continued appetite to lend to particular clients and sectors.[78] That being said, the judicial interpretation of the clause has led to actual instances of liability. While its concerning that no such exemption is in China's SPC law, the mere inclusion of such a clause does not preclude cases of lender liability.

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[66] Ibid. at s. 9607(a)(1)
[67] See Jarvis and Fordham, above n. 10 at 12-19
[68] J. O'Donovan, *Lender Liability: English Edition* (London: Sweet & Maxwell, 2005) 605
[69] 42 USC, s. 9607(a)(4)(A)
[70] See Jarvis and Fordham, above n. 10 at 11
[71] 42 USC, s. 9607(c)(1)(A)-(D)
[72] Ibid. at s. s. 9607(c)(1)(C)
[73] See Jarvis and Fordham, above n. 10 at 12
[74] EPA 1990, s. 78A(9)
[75] 42 USC at s. 9601(20)(E); See Jarvis and Fordham, above n. 5 at 12
[76] US Environmental Protection Agency, 'CERCLA Lender Liability Exemption: Updated Questions and Answers' (Office of Enforcement and Compliance Assurance, July 2007) https://www.epa.gov/sites/production/files/documents/lender-liab-07-fs.pdf accessed Friday 15 February 2019.
[77] 42 USC, s. 9601(20)(E)
[78] See Jarvis and Fordham, above n. 10 at 12

In the case of *United States v Mirabile*[79] the court was presented with the issue as to whether a lender that forecloses a facility should be seen as "participating in the management" of that facility and liable. By foreclosing the property the bank had become a "mortgagee in possession". It submitted that it was merely following its normal procedure upon a borrower's insolvency.[80] Fortuitously for the lender the court ruled that a bank that 'merely foreclosed on the property after all operations had ceased and thereafter took prudent and routine steps to secure the property' could not reasonably be held as a potentially responsible party.[81]

The secured creditor exemption was next interpreted by the *United States v Fleet Factors Corp* (1988), known as *"Fleet I"*.[82] By way of a collateral clause contained in a factoring arrangement, Fleet Factors had acquired a secured interest in a borrower paint works.[83] The USEPA discovered 700 drums each containing 55 gallons of toxic substances.[84] Fleet was allocated with the remediation liability. In the court of first instance Fleet was held liable,[85] but the decision was reversed on appeal in the case of *United States v Fleet Factors Corp* (1990), or *"Fleet II"*.[86] There, the court held that liability will attach to a secured creditor 'if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose.'[87] Thus if the secured creditor had the 'capacity to influence the financial management' of their borrowers[88] it could not rely on its status as a lender to exculpate it.[89] The decision in *Fleet II* created uncertainty for lenders as to the type of relationship they should have with their clients.[90]

In a later case the term "participates in the management" was held to mean "actual participation" as opposed to merely having the capacity to influence the actions of a borrower which covers a broad range of situations.[91] Further still, the enactment of the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act 1996[92] introduced reforms to clarify the meaning of the exemption as meaning actual participation and revoked the capacity to influence test as per *Fleet Factors II*.[93]

The above case law shows that the SPC law in China provides a new risk for lenders around the globe. It demonstrates that the judicial interpretation of the law can be

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[79] *United States v Mirabile* (1985) 15 Envtl L Rep 20992; cf. *United States v Maryland Bank & Trust Co.* 632 F. Supp. 573 (D. Md. 1986)
[80] Ibid. at 20,996
[81] Ibid. at 20,995
[82] *United States v Fleet Factors Corp*, 724 F Supp 955, 960 (SD Ga 1988)
[83] *United States v Fleet Factors Corp* (1990) 901 F 2d 1550, 1552
[84] Ibid. at 1553
[85] Ibid. at 1550
[86] Ibid
[87] Ibid. at 1557-1558
[88] Ibid. at 1557
[89] Ibid
[90] See Jarvis and Fordham, above n. 10 at 16
[91] *Re Bergsoe Metal Corp* 910 F 2d 668 (9th Cir 1990)
[92] Asset Conservation, Lender Liability, and Deposit Insurance Protection Act 1996, Pub L No 104-208, 110 Stat 3009-462
[93] 42 USC, s 9601(20)(F)(i)(II)

detrimental for lenders. If applied strictly the law can be used to enfranchise the authorities to allocate remediation liability with greater freedom to private companies, including lenders and their clients.

The UK approach: Part IIA of the Environmental Protection Act 1990

This section deals with the contaminated land regime under Pt IIA. In contrast with the above discussion on CERCLA, this section shows a wholly different regime. Pt IIA has been much less litigious than the US stance. But the regime is important as it shows how regulatory frameworks do not have to be enforced with an iron fist, generating remediation through industrial levies and private sector liability. Nevertheless lending risks still exist in Pt IIA, and these will be noted.

The demand for Pt IIA

In the UK in the 1990s there arose a public demand for a regulatory regime for identifying and remediating historic land affected by contamination.[94] In 1995, Pt IIA was inserted into the Environmental Protection Act 1990 (EPA 1990),[95] and the regime that it enforced would begin in England and Wales in 2000 and 2001, respectively.

As with the SPC law, before the enactment of Pt IIA, land affected by contamination was dealt with under the common law.[96] An early Environment Agency (EA) report into the state of contaminated land in the UK estimated that some 100,000 sites might have been affected.[97] Although a later EA report in 2009 set the figure for contamination at 325,000 sites, equating to around 300,000 hectares.[98] The UK's legacy of contamination is relatively modest in comparison to China's pollution problem.[99] For instance, figures suggest that 20 per cent of China's 133 million hectares of farmland is heavily contaminated.[100]

The enactment of Pt IIA, and the extent of the contamination problem, placed UK lenders in a position of great uncertainty. At this time, UK lenders feared the extent to which Pt IIA liability would affect their lending activities.[101] But the creation of Pt IIA

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[94] See Tromans and Turrall-Clarke, above n. 5 at 13
[95] Environment Act 1995, s 57. See Tromans and Turrall-Clarke, above n. 5 at 13
[96] Tromans and Turrall-Clarke 17
[97] Environment Agency, *Dealing with contaminated land in England – Progress in 2002 with implementing the Part IIA regime* (Environment Agency, 2002) 2
[98] Environment Agency, *Reporting the Evidence – Dealing with contaminated land in England and Wales: A review of progress from 2000-2007 with Part 2A of the Environmental Protection Act* (Environment Agency, 2009) 26
[99] International Institute for Sustainable Development (IISD), *Financing Models for Soil Remediation in China* (Chinese Academy of Environmental Planning, 2018) https://www.iisd.org/sites/default/files/publications/financing-models-soil-remediation-china.pdf accessed Sunday 24 February 2019
[100] Ibid. at 2
[101] See Brown, above n. 2 at 245

also presented an issue for foreign lenders with commercial clients in the UK. Pt IIA cemented a strong conviction into the lending community to prepare for the risks surrounding legislative non-compliance/environment-related risks.

The structure of Pt IIA

The contaminated land regime is based upon a "tiered" legislative design,[102] being made up of Pt IIA of the EPA 1990,[103] the regulations,[104] Department of Environment, Food and Rural Affairs (DEFRA) statutory guidance,[105] and scientific and technical advice.[106] The Pt IIA regulatory framework delegates local authorities (i.e. "enforcing authorities) with the power to fulfil its objectives.[107] Unlike CERCLA however there is no Superfund upon which the authorities can draw upon for remediation in a case where liable parties ("appropriate persons")[108] cannot be identified.

Worryingly the authorities often lack the necessary financial provision and technical expertise to conduct their statutory duties, and this has led some to question Pt IIA's suitability.[109] Moreover it is evident that these gaps have widened during the UK's period of austerity, where many cuts have been made to Pt IIA's economic incentives for contaminated land remediation.[110]

Much can be gauged about the structure of Pt IIA by the statutory definition given to "contaminated land":

> 'any land which appears to the local authority in whose area it is situated to be in such condition, by reason of substances in, on or under the land, that:
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> (a) significant harm is being caused or there is a significant possibility of such harm being caused; or
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> (b) pollution of controlled waters is being, or is likely to be, caused; and in determining whether any land appears to be such land, a local authority shall… act in accordance with the guidance issued by the Secretary of State… with respect to the manner in which that determination is to be made.'[111]

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[102] S. Vaughan, 'Policy, Practice and Pollution: A Study of Contaminated Land Remediation' (MSc thesis, Cardiff University September 2008) 2-3
[103] EPA 1990, Pt IIA
[104] Contaminated Land (England) Regulations 2012, SI 2006/1380
[105] Department of Environment, Food and Rural Affairs, *Environmental Protection Act 1990: Part 2A – Contaminated Land Statutory Guidance* (DEFRA, April 2012)
[106] For example, Department for the Environment, Transport and the Regions and Environment Agency, *Contaminated Land Inspection Strategies – Technical Advice for Local Authorities* (DETR and EA, June 2004). See Tromans and Turrall-Clarke, above n. 5 at 63
[107] EPA 1990, s. 78A(9)
[108] Ibid. at s. 78E(1)
[109] S. Vaughan, 'The contaminated land regime: still suitable for use?' (2017) 2 JPEL 142; S. Vaughan, 'Fit for purpose? The progress of Part 2A to date' (2009) 18(3) Environmental Law Monthly 2
[110] L.A. Brown, 'The contaminated land regime and austerity' (2015) 8(3) IJLBE 210
[111] EPA 1990, s. 78A(9). See Tromans and Turrall-Clarke, above n. 5 at 30

This definition of contaminated land shows that the local authorities are responsible, notwithstanding "special sites",[112] for inspecting their area 'from time to time'[113] and allocating liability to appropriate persons. The use of the local authorities is similar to the local people governments in China's SPC law. Also indicated are the types of "harm"[114] that may lead an enforcing authority to identify contaminated land. Lenders must have knowledge of this to protect their lending interests, and this is particularly so when taking land as security.

Pt IIA places a lot of responsibility on local authorities which are largely under-resourced.[115] The scientific expertise required to identify Pt IIA sites and the limited funding available for local government has led to "resource implications".[116] This is explained by Tromans and Turrall-Clarke:

> 'There can be few local authorities who will not be concerned about the potentially major costs of instigating and maintaining a programme of inspection of its area for contaminated land.'[117]

The resource implications in the UK may still be relevant, as there are already signs which suggest that China's approach may not be financially sufficient to meet the requirements of full remediation.[118] Following the National Soil Pollution Survey from 2014 it seems that 16.1 per cent of China's soil is contaminated, with a further 1.1 per cent labelled seriously contaminated.[119] More striking perhaps is the fact that the estimated total remediation cost is set at USD 1.3 trillion,[120] but only a fraction of that (some USD 4.546 billion) has been raised so far.[121] Lenders should be weary of this funding model as it demonstrates that remediation costs will be allocated to responsible private sector parties, their clients.

Where a "contaminant linkage" (i.e. contaminant-pathway-receptor)[122] is identified and the land is determined as contaminated land under Pt IIA, local authorities have a statutory duty to serve a "remediation notice" onto each person who is an appropriate persons by s 78E(1).[123] Liability is thereafter allocated under s 78F[124] to the

[112] Ibid. at s. 78A(9). See Tromans and Turrall-Clarke, above n. 5 at 90-99
[113] Ibid. at s. 78B(1)
[114] EPA 1990, s. 78A(4)-(5)
[115] See Tromans and Turrall-Clarke, above n. 5 at 71
[116] Ibid.
[117] Ibid. at 71-72
[118] See IISD, above n. 99 at 1
[119] Ibid.
[120] Ibid.
[121] Ibid. at 4
[122] See DEFRA, above n. 105 at para. 3.8
[123] EPA 1990, s. 78E(1)
[124] Ibid. at s. 78F

appropriate person.[125] By s 78F(2) and (3) liability may be allocated to a person who "caused" or "knowingly permitted" the contamination:[126]

> 'any person, or any of the persons, who caused or knowingly permitted the substances, or any of the substances, by reason of which the contaminated land in question is such land to be in, on or under that land is an appropriate person.'[127]

As lenders will now have to do with China's regime, the enforcement of Pt IIA empowered lenders to understand the risks.[128] This was necessary to protect themselves when lending to certain clients or exercising secured interests.[129] The Government has said that lender liability under s 78F is unlikely.[130] Lee and Egede nevertheless believe that lender liability must remain as a possibility under Pt IIA.[131] They advocate that a lender may be held accountable for contamination as a knowingly permitter through, for example, the control that it acquires over a borrower by way of its loan agreement.[132] To assist this reasoning Tromans and Turrall-Clarke suggest that the term knowingly permitting 'might also plausibly be read as denoting not only those concerned with the original introduction of the substances to the land, but also those who were subsequently in control of the land'.[133]

Thus liability could attach to a lender that has too much control over its borrower's business affairs.[134] This was also seen above in the discussion above of what constitutes "participating in the management" under CERLCA. With the introduction of the SPC law, lenders should use their experience and understanding of non-legislative compliance under CERCLA and Pt IIA to a positive advantage.

The second type of Pt IIA liability concerns owning or occupying land at s 78F(4):

> 'If no person has, after reasonable inquiry, been found who is by virtue of subsection (2) above an appropriate person to bear responsibility for the things which are to be done by way of remediation, the owner or occupier for the time being of the contaminated land in question is an appropriate person.'[135]

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[125] Ibid. at s. 78(A)(9)

[126] See DEFRA, above n. 105 at para. 7.3. To clarify, the Statutory Guidance describes this type of liability as "Class A" liability.

[127] EPA 1990, s. 78(2) and (3)

[128] See Brown, above n. 2 at 245; R. Griffith, 'New liabilities for the banker in England' (1993) 4 IBLJ 435

[129] See Brown, above n. 30 at 141

[130] Hansard, HL Vol.565, col.1497. See also, Tromans and Turrall-Clarke, above n. 5 at 175; T. Egede and R. Lee, 'Bank Lending and the Environment: Not Liability but Responsibility' (2007) Nov JBL 868

[131] See Egede and Lee, above n. 130 at 877

[132] Ibid. at 868

[133] See Tromans and Turrall-Clarke, above n. 5 at 150

[134] See Lee and Egede, above n. 130

[135] EPA 1990, s. 78F(4)

While "occupier" remains undefined, "owner" is defined by s 78A(9):[136]

> 'a person (other than a mortgagee not in possession) who, whether in his own right or as a trustee for any other person, is entitled to receive the rack rent of the land, or, where the land is not let at a rack rent, would be so entitled if it were so let.'[137]

The above section shows that a mortgagee that is not in possession of the land will not be held liable as an "owner". Pt IIA's definition of "owner" largely precludes a lender from exercising its security in the case of contaminated land, for otherwise it may be served with a remediation notice.

Ownership liability for land remediation is also assured under the SPC law, as the regime allows for "land-use rights" holders to be responsible in the situation where the responsible person cannot be found. While it is not possible to acquire private ownership of land in China,[138] the fact that land-use rights holders can be liable is nevertheless something that will have to be considered by lenders.

The risks to lenders following China's regime

Risks have always existed in lending. For instance, Polonius famously advised his son in Shakespeare's *Hamlet* that:

> 'Neither a borrower nor a lender be;
>
> For loan oft loses both itself and friend,
>
> And borrowing dulls the edge of husbandry.'[139]

Today, the threats that may be posed to lenders are much more complex and need to be considered on an international stage.[140] It is apparent that China's SPC law creates risks for both lenders based in China and foreign banks with customers situated in the Chinese economy. The risks are placed into categories to better appreciate how the new legislation may affect commercial lending activities. Broadly speaking, the risks may be placed into three categories: (1) "market risk", (2) "industry risk" and (3) "firm risk".[141] These categories of risk are explored sequentially below. It is noteworthy that this article does not provide a detailed analysis of environmental due diligence in banks. This topic falls outside of the remit of this article's analysis and is a subject unto itself.

Market risk

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[136] See DEFRA, above n. at para. 7.3. To clarify, the Statutory Guidance describes this type of liability as "Class B" liability.

[137] EPA 1990, s. 78A(9)

[138] E. Zhang, 'Press Article: China's version of leasehold – Law' (Pinsent Masons, February 2007) https://www.pinsentmasons.com/mediafiles/1905363983.htm accessed Tuesday 19 February 2019

[139] W. Shakespeare, *Hamlet* (Act 1, scene 3, 75-77)

[140] See Case, above n. 6

[141] J Moffatt, *Moffatt's Trusts Law* (eds J. Garton, G. Bean and R. Probert, 6th edn, CUP 2017) 464

The first category of risk (as above) is the broadest. It describes the impact that the SPC law may have to the economic market generally and how market changes may affect lenders' securities.[142] It is more accurately defined as:

> 'the risk of losses in on and off-balance sheet positions arising from adverse movements in market prices. From a regulatory perspective, market risk stems from all the positions included in banks' trading book as well as from commodity and foreign exchange risk positions in the whole balance sheet.'[143]

Exempli gratia, the inception of the SPC law in China may have adversely impacted the market value of affected land and decrease its security value. Moreover market risk may also affect a bank that wishes to bring a customer to a particular market through an initial public offering (IPO) or merger and acquisition (M&A).[144] Thus the specific issue here is that a bank may have prospective liabilities to investors if the risks under the SPC law are not disclosed, and investors' capital is diminished as a consequence.[145] Tellingly there is also the question of the risks that may present themselves from lending to companies with parent companies that reside in the US or Western Europe and have subsidiaries operating in emerging markets.

This category of risk may be reduced by lenders if they spend time understanding the impact that the new law has had to the economic and securities markets. It is advised that the lenders thoroughly investigate their borrowers through their risk management systems, before undertaking any activity that may be injurious to investors such as an IPO or M&A.

Industry risk

The second category of risk that may be created by the new law is industry risk. This describes the risks posed to certain industries with links to soil pollution.[146] Legal liability under the SPC law can be applied to a plethora of different industries, but the new regime applies particularly to agricultural land (section II) and construction land (section III). Therefore, borrowers with links to these to industries should be seen as especially high risk by the lending community following the bringing into force of the SPC law.

It is important for lenders to review their customers working in these areas to determine the extent of their actual or prospective liabilities in light of the new regime. This also applies to foreign banks that have provided loan finance to Chinese customers working in these sectors. The more specific advice for firm risk (detailed below) with also assist in resolving the risks to specific industries. Lenders are advised to carry out

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[142] Ibid

[143] European Banking Authority, 'Market Risk' (*European Banking Authority*, no date) https://www.eba.europa.eu/regulation-and-policy/market-risk accessed Tuesday 19 February 2019

[144] See Brown, above n. 59 at 235-237

[145] Ibid. at 236-237

[146] See Moffat, above n. 141

risk checks with their existing and future customers operating in particularly high-risk industries.

Firm risk

Firm risk describes the risks that may emerge by a customer's non-compliance with the law,[147] *viz*: (i) direct lender liability; (ii) indirect risks (credit and security risks); and (iii) reputational risk.[148] This article has shown that a lender with too much control over its borrowers or in possession is more likely to be legally liable for the remediation costs. In regard to (ii), if a borrower is found directly liable this may affect its ability to repay its debts, and land that is subject to the SPC law may also depreciate.[149] Such things may lead to credit and security risks. Finally (iii) describes the situation where a lender's reputation is adversely affected by way of its association with a polluting borrower.[150]

The risks described above are not limited Chinese lenders but extent to foreign banks that have customers based in China. As the analysis of the US and UK showed, lenders should be careful as to the degree of control that they assert over their clients. Caution should also be applied when exercising securities, as being a mortgagee in possession has proved to be a means to transfer liability to lenders. Generally the risks associated with a firm can be significantly reduced by better understanding the business operations and level of environmental awareness of individual customers. Lenders should take time to learn the legislative non-compliance risk under the SPC law and educate their customers about the risks that may emerge because of it. Lenders should seek to utilise their risk management frameworks to assist in reducing the risks; this may mean commissioning external environmental consultants to provide risk reports, for instance.

Conclusion

This article has provided an overview of the new regime that is enforced by the SPC law which came into force on 1 January 2019. It has analysed the regime in light of the existing regulatory frameworks in the US (CERCLA) and UK (Pt IIA). Where the Chinese law bears some resemblance with the above regimes, the article has discussed the impact that it may have on lenders. CERCLA showed that lender liability for remediation costs is more than a theoretical possibility. So too did it demonstrate that judicial interpretation of statutory provisions may not favour lenders. Pt IIA was incorporated into the article's discussion because it represents the other side of the coin to CERCLA; its approach to land remediation has not been as direct and the regime has been plagued with resourcing issues. Finally, three categories of risk were used to show the probable issues that the enactment of the SPC law may bring for lenders. Having highlighted the risks, general advice was provided for lenders to reduce the risks.

To sum up, while China's regime creates a new legislative threat for lenders and their borrowers, financial institutions around the world have had to content with the

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[147] Ibid.
[148] See Brown, above n. 2
[149] See Jarvis and Fordham, above n. 10 at 147
[150] Ibid.

creation of such risks for the past three decades. This article therefore suggests that lenders can learn from the “lessons from the West”, and need not be the proverbial canary in the coalmine when it comes to non-legislative compliance risks for land remediation in twenty-first century lending.

Word Count: 7,151